

FOREIGN MILITARY SALES ACQUISITION POLICY AND PROCESS

INTRODUCTION

The foreign military sales (FMS) process fundamentally is an acquisition process. Under FMS, a foreign government or international organization identifies a need for a military-related item or service and chooses to acquire from the U.S. government (USG). The government-to-government sales agreement governing the acquisition is the letter of offer and acceptance (LOA). To fulfill the LOA requirements, the USG may supply items or services from on-hand Department of Defense (DoD) resources or the USG may purchase from industry for subsequent delivery to the FMS customer.

This chapter primarily examines acquisition as it relates to the USG's process for purchasing material or services by means of contracts with industry. The goal of the contracting discussion is to highlight where and how FMS procurements fit into the normal DoD procurement process. Additionally, this chapter will discuss the international business agreement referred to as an offset. The offset concept is defined, the USG policy regarding offsets is presented, and the means to address offsets within FMS are explained.

Within DoD, the term acquisition is also used to refer to the entire lifecycle process DoD uses to develop, test, evaluate, produce, and sustain weapon systems to satisfy formally identified DoD military capability requirements. This formalized acquisition process is referred to as the defense acquisition system (DAS). Chapter 13, "International Armaments Cooperation" of this text discusses how issues that affect future foreign sales of major systems are addressed within the DAS during the system development process.

The DoD uses the term acquisition to encompass multiple functional areas. In fact, the Defense Acquisition University (DAU) offers a variety of courses for personnel within thirteen different career fields that support acquisition. These acquisition career fields include the following: lifecycle logistics, auditing, contracting, facilities engineering, contract property management, information technology, cost estimating and financial management, manufacturing and production, program management, purchasing, science and technology, systems engineering, and testing and evaluation. To review the courses offered by the DAU, visit their web site at: <http://www.dau.mil/schedules/schedule.asp>.

GLOBAL MILITARY MARKETPLACE

When an international customer requires a military item or service, it must find a source to fulfill that need. Ideally, from its national perspective, there are many economic and political factors that make acquisition from a domestic source the preferred choice. However, in today's high technology military environment, a substantial financial investment is required to conduct the research, development, testing, and to establish production capability for a military system. In addition to the financial investment, considerable time is required to accomplish this process. Given these considerations, many nations fulfill certain military needs by procuring from other governments or from foreign commercial firms.

United States Item Preference

From a security assistance perspective, the potential foreign customer must first determine whether to acquire a United States (U.S.) system rather than developing a domestic system or purchasing some other country's system. If the foreign customer selects a U.S. system, it must next decide whether to purchase through the government-to-government security assistance process or to make the purchase through the government-to-industry direct commercial sales (DCS) process.

The DoD is generally neutral regarding whether a foreign customer chooses to purchase via FMS or DCS. Although officially neutral regarding the procurement method (FMS or DCS), DoD does have a specific preference that friendly nations chose to purchase U.S. systems. The reason for the U.S. preference relates to the political, military and economic benefits resulting from the U.S. and its friends using the same military equipment.

Foreign Military Sales Procurement Rationale

Chapter 15, "A Comparison of Foreign Military Sales and Direct Commercial Sales", compares some of the advantages and disadvantages of FMS and DCS procurements. This chapter will not review all the pros and cons; however, the *Security Assistance Management Manual* (SAMM) states that a primary reason that international customers choose the FMS system is because the DoD makes purchases on the customer's behalf using the same USG regulations and procedures that DoD uses to make procurements for itself. As a result, the customer receives the same benefits and protections that are built into the DoD acquisition process. This can be a considerable benefit when the customer may be spending hundreds of millions or perhaps billions of dollars to acquire a military system. This chapter examines how the DoD uses its existing acquisition policies and procedures to procure articles and services in fulfillment of LOA agreements.

Foreign Military Sales Content

Typically, FMS system sales consist of weapon systems that DoD has already developed, produced and fielded for its own use. DoD policy states that the USG will only agree to sell systems through FMS that have been approved for full rate production for U.S. forces. The key acquisition decision point, from an FMS perspective, is the full rate production review. If a foreign customer requests an LOA for a system that has not yet been approved for full rate production, a policy waiver is required. In this situation, the Defense Security Cooperation Agency (DSCA) will request concurrence from the Under Secretary of Defense for Acquisition, Technology, and Logistics [USD (AT&L)] before offering an LOA for a system that is still under development.

The reason for this policy concerns future supportability and interoperability issues. Prior to the full rate production decision, there is the risk that the U.S. may decide not to produce the system. This would present an undesirable situation if the U.S. has committed under an LOA to deliver a system to an FMS customer but decided not to deliver this same system to U.S. forces. The FMS customer would be faced with nonstandard support to sustain the system and might lack interoperability with U.S. forces. If the waiver is approved, the LOA for the FMS must include a special note identifying the risk that the USG may not place this system into production. This waiver policy is often referred to as the Yockey waiver named after a former Under Secretary of Defense for Acquisition.

Although some FMS customers may purchase specific items or services independent of a major DoD end item system, most security assistance programs are built around the sale of one or more major DoD weapon systems. Under the FMS approach, major weapon system sales are accomplished using the total package approach (TPA). TPA provides the FMS customer the weapon system plus

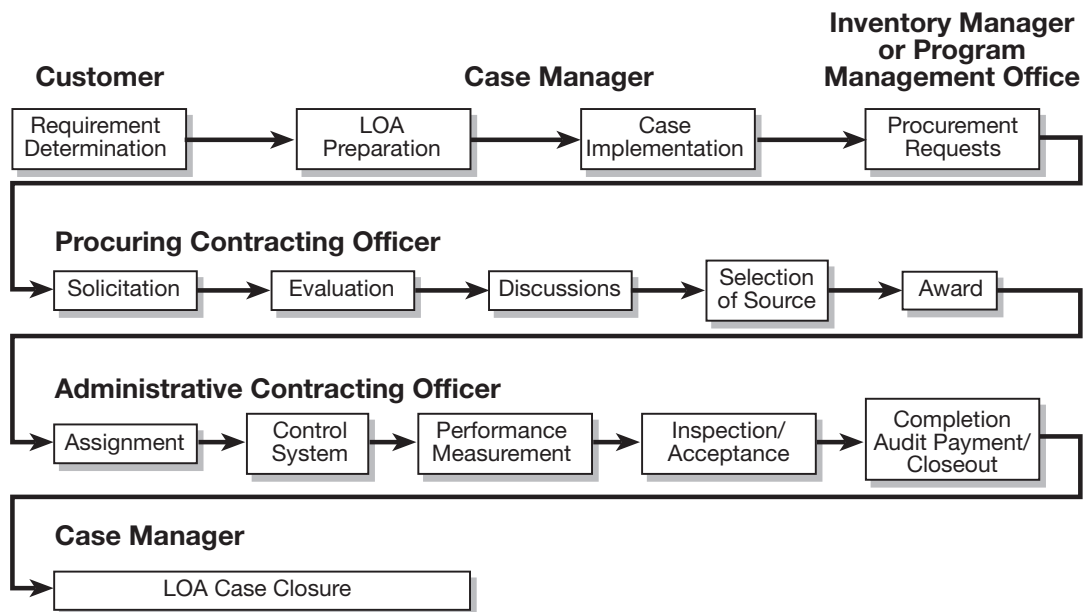
all the necessary support elements to operate and sustain the system for an initial period. Subsequent FMS follow-on support cases continue to sustain the system throughout its operational life.

Because the FMS sales process is accomplished using existing DoD procurement regulations and policies, the material and services provided under FMS will generally be U.S. origin products. In the SAMM C4.4.1, it states that the DoD will not enter into LOAs that commit to procurement in foreign countries unless DSCA has approved an exception.

CONTRACTING FOR FOREIGN MILITARY SALES

It is important to recognize that the Arms Export Control Act (AECA) permits FMS sales both from DoD stocks and by means of DoD contracting to acquire material or services directly for the FMS customer. Generally, DoD inventory levels are established to support DoD's own level of operations as well as to provide a contingency reserve of material. When an FMS customer submits a requirement under the authority of an LOA, the DoD can only use its current inventory for FMS demands if it can do so without negatively impacting its own readiness. As a result, it may be necessary for DoD to procure the required FMS item by contracting with industry rather than supply from stock. There is an exception to this policy under a special program called the cooperative logistics supply support arrangement (CLSSA). More information on the CLSSA program is contained in later Chapter 10, "Logistics Support of International Military Sales" The overall process to contract for FMS is depicted in Figure 9-1.

Figure 9-1
Foreign Military Sales Contracting Process



Buyer and Seller Relationship

When an FMS customer accepts an LOA, it enters a government-to-government agreement to purchase military items or services from the USG. In regard to the LOA, the FMS customer is the buyer and the USG is the seller. The USG may provide the articles or services from stock but often must contract with industry to acquire the items or services for delivery to the FMS customer. In the procurement contract, the USG becomes the buyer and the vendor from industry is the seller. The

FMS customer is not a legal participant in the procurement contract with industry. The USG is acting on the FMS customer's behalf. As far as the vendor is concerned, it is under contract and directly obligated to the USG and has no direct contractual relationship with the FMS customer.

Letter of Offer and Acceptance and Contract Relationship

The LOA documents the customer's requirement and provides both the authority and funding to initiate contracting actions. In preparing the LOA, the case manager must clearly understand the customer's requirement to ensure the LOA addresses all of the customer's requirements. At the same time, the case manager must also ensure that any special procurement issues from the contracting officer are adequately discussed with the customer and appropriately documented within the LOA. The goal is to have an LOA that can be implemented by means of a contract that both fulfills the customer's desires and is consistent with all U.S. contracting regulations. The key to success in this area is clear communication early in the LOA preparation process between the customer, the case manager and the applicable U.S. contracting organization.

Department of Defense Infrastructure for Foreign Military Sales Acquisition

Before discussing the contracting process, an introduction to the DoD's structure for FMS acquisition is required. The DoD does not maintain a separate acquisition infrastructure just for FMS. Instead, the DoD supports FMS by using the same acquisition infrastructure already established to support its own acquisition and logistics needs.

Major System Acquisition

For major weapon systems, the military departments (MILDEPs) establish program management offices responsible for developing and acquiring the initial system. The program management office manages all the technical aspects of the systems delivered to U.S. forces, procures any additional quantities for DoD and engineers improved or modified configurations. A program office management team will typically consist of a weapon system program manager supported by personnel from several functional disciplines such as engineering, testing, contracting, logistics, and financial management.

When an FMS customer purchases a major weapon system, the same program management office that oversees the acquisition of that system for the DoD will also manage the acquisition for the FMS customer. The system program management office may acquire the FMS quantities either as individual procurements or by merging the FMS requirements with DoD's requirements on the same U.S. contract. The contracting officer within the overall program management office is the only individual with the authority to enter into contracts on the behalf of the USG. In this role, the contracting officer will be supported by the functional expertise of the members of the program office team in establishing source selection criteria, evaluation offers, and negotiating the terms and pricing of the contract.

In order to accomplish successful program execution, major FMS system sales may require program office services beyond those provided by the standard level of service discussed in the SAMM C.5. Additional management services will be funded by a well-defined services line on the LOA. The SAMM requires each service line to include a LOA line item note to describe the details of the services provided and to identify the length of the service performance period.

Follow-on Support Acquisition

In regard to standard follow-on support, FMS requirements will be routed to the DoD inventory control point (ICP) that manages the item for the DoD. The item manager with responsibility for the requisitioned item will decide whether the FMS order should be supported from on-hand stock, held on

back order for support from materiel due into stock, or placed on a purchase request for procurement. The purchase request, containing a fund cite from the applicable FMS LOA, will be routed to the ICP's contracting activity. A contracting officer will award a contract with industry to fulfill the FMS requirement. Based on the volume of FMS activity, the ICP's manpower may be augmented with additional positions funded by the overall FMS administrative fund. For standard follow-on support, the same DoD functional organizations that purchase the respective item for the DoD will also be responsible for FMS purchases.

Nonstandard Acquisition

For the FMS customer, the DoD decision to curtail or end operations of a given system may impact support. Many examples exist where DoD currently supports systems operated by FMS customers that the DoD no longer actively retains in its inventory, such as the F-5 and the F-4 aircraft. In these situations, components of the system may transition from being standard to nonstandard items. Nonstandard requirements are, by definition, items that are not actively managed in the DoD supply system for U.S. forces. Nonstandard FMS requirements have historically been difficult to support because there is no existing management or acquisition infrastructure within the DoD to reuse in support of FMS. Because no ICP activity manages or buys these items for DoD, the MILDEPs have contracted with commercial buying services (CBS) to procure most nonstandard items in lieu of DoD directly contracting for nonstandard items. More information on CBS is presented in Chapter 10, "Logistics Support of International Military Sales" of this textbook.

Contracting Regulations

The Federal Requisition Regulation (FAR) system was established for the codification and publication of uniform acquisition policies and procedures to be used by all USG federal agencies. The federal acquisition regulation is the primary document governing contracting actions undertaken by the USG. Many of the FAR requirements originate in various laws passed by Congress. One of the best known legislated requirements is the Competition in Contracting Act (CICA). Like other federal regulations, the FAR is considered to have to force and effect of law. The current version of the FAR is publicly available at: <http://www.arnet.gov/far/>.

In the LOA, standard term and condition 1.2 states that the USG will follow the same regulations and policies when procuring for FMS as it does when procuring for itself. This condition in the LOA is referring to the FAR. The SAMM which provides overall policy for the conduct of FMS states that FAR provisions applicable to DoD will apply to FMS procurements.

Given that the DoD procures many unique items, the Defense Federal Acquisition Regulation Supplement (DFARS) was created to supplement the FAR. Each of the MILDEPs and their subordinate commands have, in turn, issued further supplements to the DFARS to aid contracting personnel in implementing FAR and DFARS provisions. It is important to recognize the hierarchy in the contracting regulations. The FAR remains the overarching authority. Each subordinate supplement may amplify and expand on the principles of the FAR but cannot contradict. Accordingly, each supplement issued by the MILDEPs can only amplify on the principles in the DFARS. It is interesting to note that within the DFARS itself, Subpart 201.104, it specifically states that the DFARS applies to contracts issued by the DoD in support of FMS. The current version of the DFARS is available at: <http://www.acq.osd.mil/dpap/dars/dfars/>.

CONTRACT SOURCE SELECTION

The CICA requires USG agencies to promote the use of full and open competition in procurements. This legislated requirement is detailed in the FAR Part 6 which discusses contract competition. In a competitive procurement, the USG makes public notification of its intent to purchase. This public notification used to be accomplished via a publication, the *Commerce Business Daily*. The USG currently electronically posts these notifications on its Federal Business Opportunities web site: <http://www.fedbizopps.gov>. These public notifications are commonly referred to as solicitations. Any interested vendor has the opportunity to submit a bid or proposal to the USG in accordance with the solicitation instructions to be considered in the contract source selection process. Per the FAR, all federal agencies are required to use competitive procurement procedures as the normal method of acquisition. Competition is the typical or default method of procurement.

Under certain circumstances, the FAR does permit, as an exception, the use of noncompetitive procurement procedures. In a non-competitive procurement, the USG negotiates with a single source at the exclusion of all other potential sources. In order to use the exception to normal procurement procedures, a justification must be prepared to document the reasons why a noncompetitive procurement is required rather than conducting a competitive procurement. According to the FAR, noncompetitive procurements are permitted only when justified based on one or more of the following seven conditions.

- When property or services required are available from only one responsible source and no other type of supply or services will satisfy agency requirements
- When the agency's need for the supply or services is of an unusual and compelling urgency
- It is necessary to award the contract to a particular source or sources in order to:
 - Maintain a facility, producer, manufacturer, or other supplier available for furnishing supplies or services in case of a national emergency or to achieve industrial mobilization
 - Establish or maintain an essential engineering, research, or development capability to be provided by an education or other nonprofit institution or a federally funded research and development center
 - Procure the services of an expert for use in any litigation or dispute involving the federal government
- When the terms of an international agreement or a treaty between the U.S. and a foreign government or international organization specify a source
- If a statute expressly authorizes or requires that the procurement be made through another agency or from a specified source
- When the disclosure of the agency's needs would compromise the national security
- When the head of the agency determines that it is necessary in the public interest to use procedures other than competitive procedures

Foreign Military Sales Competitive Source Selection

The LOA standard terms and conditions reflect a preference for competition in contract award as mandated by the CICA. LOA condition 1.2 states that the USG is responsible for selecting the contractor to fulfill the LOA requirements. Additionally, condition 1.2 states that the U.S. will select the contractor on the same basis as it makes contractor selections to fulfill its own requirements. In other words, the norm for conducting FMS contract awards is for the U.S. to use its competitive contract award process to select the contractor to fill the FMS customer's requirement. The SAMM states that competitive source selection will be utilized to the maximum extent possible in support of FMS. [SAMM, Section C6.3.4]

Foreign Military Sales Sole Source by Customer Request

Section 1.2 of the LOA standard terms and conditions does permit the FMS customer to formally request a noncompetitive procurement be conducted on its behalf. Within the FMS community, a customer's request for a noncompetitive contract award is commonly referred to as a sole source request. A customer's sole source request must comply with the criteria in the SAMM, Section C6.3.4.3, and should be submitted with the LOR. The sole source request must have sufficient justification to demonstrate that sole source procurement is necessary to meet the objective needs of the customer. The SAMM, Table C6.T2, identifies the following situations where sole source procurement may be considered to meet objective customer needs. The SAMM does not limit the customer to these five reasons but most customer sole source requests will fall into one of these areas.

- One of the numerous suppliers can deliver faster, and the situation is urgent enough to forego the benefits of the competitive process.
- Procurement is for a non-standard item which is not active in the DoD supply system, and the customer country knows of a specific source for the item.
- A country has an established history of procurement for articles or services from a particular source and to change would adversely affect an ongoing program. For example, this could include an ongoing maintenance program where a particular contractor is providing technical services and the customer country desires to continue with this same contractor for the next contract period.
- The foreign purchaser has conducted its own source selection competition but desires to procure using the FMS process. In using this sole source justification, the customer country must provide the following: a copy of the country's request for proposal, invitation for bid, or request for tender; a description of the method used to advertise the requirement and any restrictions placed thereon; and a narrative summary of the country's source selection criteria and method of evaluation. If price is not the sole selection criterion, the country must identify the weight that was given to each criterion.
- When a country has established a history of procurement for articles or services from a particular source and needs to continue procurement from that source to continue standardization of equipment with consequent benefits of logistics support.

Sole source requests are received by the implementing agency (IA) responsible for preparing the LOA. The IA determines whether the request meets the requirements of the SAMM. Sole source

requests determined to be patently arbitrary or a discriminatory exclusion are to be disapproved. All responses informing of a sole source disapproval must be coordinated with DSCA.

In addition to reviewing the customer's sole source justification, the SAMM also recommends that the sole source request be forwarded to the applicable contracting office for information and advice. Typically, the contracting officer will have experience procuring this same item or service for DoD. DoD maintains data on past procurements. Based upon the contracting officer's experience and access to procurement data, the USG may possess additional information that indicates the customer's sole source selection may not be a prudent procurement choice. In these instances, the contracting officer can inform the case manager, who would, in turn, provide this additional information to the FMS customer for consideration.

Sole source requests typically specify a particular prime contractor. A sole source request may also request that specific subcontractor be utilized by the prime contractor. Specifying sole source subcontractors limits the ability of DoD to hold prime contractors to specific performance and cost parameters. The reason is that the prime contractor normally would be responsible for selecting and overseeing subcontractor work to ensure all contract targets are achieved. When a sole source subcontractor is specified, the prime contractor will be required to use certain subcontractors. This removes the prime contractor's ability to shift work away from under performing subcontractors and can relieve him from certain contract liabilities. If the FMS customer chooses to request specific subcontractors, the purchaser should be advised of the additional risk. [SAMM C6.3.4.2]

Per SAMM, Section C6.3.4.6, approved sole source requests must be documented in an LOA sole source note. The reason for documenting the sole source approval in the LOA is to comply with the CICA and FAR. The fourth CICA exception permits a noncompetitive procurement when the terms of an international agreement call for procurement from a specific source. For FAR and CICA purposes, the LOA is considered an international agreement. As such, an LOA containing an approved sole source permits the USG contracting officer to initiate a noncompetitive procurement at the FMS customer's request and still be in compliance with the FAR. A copy of the accepted LOA containing the sole source note should be forwarded to the applicable contracting officer to permit compliance with the FAR 6.3 requirements for noncompetitive procurements.

As an exception to policy, a sole source request may be considered after LOA acceptance. The same sole source review and decision process would occur. If approved, the accepted LOA would require an amendment to be issued to incorporate the sole source note. However, if the request for sole source is submitted by a customer official known to have equivalent or greater authority than the official who signed the LOA, then the sole source note can be added to the LOA by a modification. [SAMM, Section C6.3.4.1]

Foreign Military Sales Sole Source without Customer Request

Although most FMS sole source procurements originate with the foreign customer, such procurements can originate unilaterally with the USG. In this situation, although the FMS customer did not have any specific desires for a particular sole source, the USG managers conducting the procurement may determine that the FMS procurement needs to be conducted on a noncompetitive basis. In this case, the USG managers must generate a written justification for the noncompetitive procurement based on one of the other CICA exceptions (i.e., other than international agreement).

An example of a sole source without a FMS customer's request would be a major system acquisition. If the customer wanted to purchase F-16s through FMS, the customer would not need to submit a sole source request that the F-16s be purchased from Lockheed-Martin. Under the FAR, after initial source

selection, major weapon systems are considered to be single source items. The USG will not conduct a competitive procurement for these type items. The USG would unilaterally justify a noncompetitive procurement based the item being a single source.

Competitive Source Selection

Unless the LOA reflects an approved customer sole source request or the contracting officer has justified a noncompetitive award in accordance with another of the CICA exceptions, a competitive source selection process will be conducted. It is important for the FMS customer to recognize that the competitive process requires time to accomplish. Foreign customers often wonder why it may take so long to deliver an item under FMS. Part of the item lead time concerns the time necessary to plan and conduct the competitive source selection process.

Per the FAR, competitive source selection can be accomplished using one of three methods: simplified acquisition procedures, sealed bids or by negotiation. This represents a hierarchy of preferred use. For any given procurement, the first option should be to consider whether the procurement qualifies to be accomplished under simplified acquisition procedures (SAP). If it does not meet the criteria for SAP, the next option is to evaluate whether sealed bidding criteria can be met. The final option, when the first two types cannot be applied, is to use negotiation. This hierarchy reflects the degree of difficulty and cost invested by the USG in the procurement. The SAP is the easiest and least costly type whereas negotiation involves the most government resources and incurs most cost.

- Simplified acquisition procedures are aimed at streamlining government procurement. Price quotes are solicited from vendors, and the government then issues an order to the vendor determined to provide the best value. Given the reduced bureaucratic approach, dollar value limitations have been placed on the situations in which this method can be used. Purchases up to \$100,000 in noncommercial items are permitted. Because of the price regulating influences of the commercial marketplace, this method can be used for purchases of commercial items up to \$5.5 million. FAR Part 13 describes this process.
- Sealed bids are used if time permits the solicitation, submission, and evaluation; if the award can be made on the basis of price and other price-related factors; if it is not necessary to conduct discussions; and if there is a reasonable expectation of receiving more than one sealed bid. Under sealed bidding, the government advertises its requirements and invites interested firms to submit a bid. Vendors interested in competing for this business submit their respective bids in accordance the invitation for bid instructions. Generally, there will be a deadline date for bid submission and a date established when the government will open the bids. On the bid opening day, the USG will open and review all the bids submitted. The contract will most likely be awarded to the firm that submitted the lowest price bid that was responsive to the requirements. Responsive means that the bidder offered what the government requested and not something else. FAR Part 14 describes this process.
- Negotiation is used if any of the above conditions for simplified acquisition or sealed bidding cannot be met, and when it is necessary to conduct discussions with prospective contractors. The main steps in this processes as described in FAR Part 15 are:
 - USG solicits competitive proposals

- Offerors prepare and submit proposals
- Competitive range determination is made by the USG to decide which offerors to conduct written or oral discussions
- USG technical and price evaluation of proposals. In this process, the USG typically has two evaluation teams separately consider the merits of each proposal. One team will be comprised of technical type individuals capable of distinguishing between the relative technical and qualitative benefits presented by each proposal. The other team, comprised primarily of financial and business type individuals, will review the price related factors of each proposal.
- USG selects and awards a contract to that offeror whose offer is most advantageous to the government. The most advantageous or best value offer is the one determined to provide the best combination of performance and price. It is not necessarily the lowest price offer or the best performing product/service.

Advertising for Competition

The federal government has entered the electronic age and now officially advertises all federal contracting opportunities valued over \$25,000 from a single web site at <http://fedbizopps.gov>. FMS requirements will also be advertised on this web site for interested vendors.

Set-aside Procurements

As previously stated, all procurements for FMS will be conducted in compliance with FAR and DFARS policy and procedures. As such, the potential does exist for certain FMS procurements to be set-aside for special classifications of businesses to exclusively compete. This is another example of the USG conducting FMS procurements in the same manner as it conducts procurements for itself.

Although procurements may be set-aside, the FAR also requires that contract awards be made to responsible contractors. A responsible contractor is one that the government believes to possess the ethics, resources, capability and capacity to successfully deliver the contract requirements in a timely manner.

Contract Types

The decision concerning the type contract to use in an FMS procurement is an internal USG decision. The USG will select the contract type for FMS in the same manner that it selects contract types for itself. Often, the USG will combine its own requirements with FMS requirements on a single contract. Although the USG will select the type contract used to procure for FMS, the contract type may impact the customer when it comes to timely case closure. Under FMS, the financial policy is for the USG to recover the total cost of performance against the FMS case. The type contract used in making FMS procurements can impact how long it will take to determine the total cost. As a result, the type contract can ultimately impact how long it will take to close the FMS case. More information on FMS case closure is contained in Chapter 12, "Foreign Military Sales Financial Management."

There are two broad categories of contracts used in DoD procurement: fixed-price and cost-reimbursement. Within these two broad categories a wide variation of contract types is available to the government and contractors.

- Fixed-price contracts provide for a price that is generally not subject to any adjustment, regardless of the contractor's costs experienced in performing the contract. This contract type makes the contractor responsible for cost risk and the resulting profit or loss. It imposes a minimum administrative burden upon the contracting parties. Under these contracts, the contractor has greater responsibility for the costs with little or no cost risk to the government. When a contractor delivers materiel or services under a fixed-price contract and the USG accepts the product, no significant further action is required by either party. The government will pay the predetermined fixed price and the contract can be closed. The FAR standard for closing fixed price contract is within six months following final delivery.
- Cost-reimbursement contracts provide for payment of allowable incurred costs to the extent prescribed in the contract. These contracts are suitable for use only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use a fixed-price type of contract. Under these contracts, the contractor has less responsibility for the final cost and the cost risk to the government is higher.
- Under a cost-reimbursable contract, the contractor will submit contract performance cost data to the USG. The USG must then review this cost data to validate that the costs claimed by the contractor are allowable, allocable, and reasonable.
 - Allowable means the cost category being claimed is considered to be a legitimate expense category by FAR cost standards.
 - Allocable means the proportion of the overall cost being claimed under the respective contract is an appropriate share representative of the resources actually applied to the respective contract.
 - Reasonable means that the amount claimed by the contractor for an allowable and allocable share does not exceed that which would be incurred by a prudent person in the conduct of competitive business.
- Due to the time necessary for the contractor to gather and report supporting cost data and for the USG to perform any necessary review and audits of the cost data, it may take a lengthy amount of time to close out a cost reimbursable contract. The FAR standards for closing cost contracts, following final delivery, is within twenty months for contracts without indirect rates and within thirty-six months for contracts with indirect rates.

SPECIAL FOREIGN MILITARY SALES CONTRACTING CONSIDERATIONS

Throughout this chapter, it has been emphasized that contracting for FMS will be in accordance with normal FAR and DFARS policies and procedures. As a result, contracting for FMS essentially mirrors the process DoD uses in contracting for itself. As may be expected, there are a few peculiarities associated with FMS contracts. The DFARS contains a special subpart that addresses these peculiarities. This subpart is DFARS 225.7300, "Acquisitions for Foreign Military Sales."

Foreign Military Sales Solicitation and Contract Marking

DFARS states that all solicitations to industry for FMS requirements should separately identify the requirement as being for FMS and also indicate the specific FMS customer. It is important for industry to know this information because special rules concerning cost allowability for FMS may apply as

discussed later in this chapter. Additionally, all awarded contracts containing FMS requirements are to be marked “FMS Requirement” and are to include the FMS case identifier code.

Contracting Officer Involvement in Letter of Offer and Acceptance

The only individual legally authorized to contractually commit the USG is a warranted contracting officer. A warrant is a specific certification provided to a federal employee or military officer that authorizes that person to commit the USG in contracts. The contracting officer along with other procurement professionals on the team will take the requirement identified on the LOA along with the LOA funding to ultimately award a contract with industry that is compliant with the FAR and DFAR requirements.

Potential future problems arising when the LOA is implemented for procurement can be identified and minimized through close coordination between the case manager and the contracting officer. The DFARS states that the role of the contracting officer is to assist the FMS case manager by:

- Assisting in preparing the price and availability data
- Identifying and explaining all unusual contractual requirements or requests for deviations
- Reviewing sales commissions and other unique fees
- Communicating with potential contractors
- Identifying any logistics support necessary to perform the contract

Contract Pricing for Foreign Military Sales

The FAR and DFARS provisions are intended to ensure procurement at fair and reasonable prices. In addition to protecting the USG interests, the FAR and DFARS also attempt to treat contractors fairly. The provisions of DFARS Subpart 225.7303-2 recognize that, in working to fulfill FMS contract requirements, contractors may incur legitimate additional business expenses that they normally do not incur in DoD only contracts. As a result, DFARS Subpart 225.7303-2 permits certain types of costs to be allowable for FMS contracts. Although the same pricing principles are used, FMS contract prices are not always identical to the DoD contract prices. Examples of such costs include:

- Selling expenses
- Maintaining international sales and service organizations
- Sales commissions and fees in accordance with FAR, Subpart 3.4
- Sales promotions, demonstrations, and related travel for sales to foreign governments
- Configuration studies and related technical services undertaken as a direct selling effort to a foreign country
- Product support and post-delivery service expenses
- Operations or maintenance training, training or tactics films, manuals, or other related data

- Technical field services provided in a foreign country related to accident investigations, weapon system problems, operations/tactics enhancement, and related travel to foreign countries
- Offset costs which are further defined later in this chapter

Although DFARS 225.7303-2 does permit certain costs for FMS to be allowable. DFARS 225.7303-5 limits this special cost allowability provision to only apply to procurements originating from LOAs financed with either customer funds or repayable credits. If the LOA is financed by USG grant funds such as Foreign Military Financing Program (FMFP) funds or Military Assistance Program (MAP), then the cost allowability rules default back to the standard DoD criteria.

Sales Commissions

Sales commissions, referred to in the FAR as contingent fees, are generally allowable if the commission or fee is paid a employee or a selling agency engaged by the prospective contractor for the purpose of legitimately securing business.

DFARS, 225.7303-4 permits contingent fees to exceed \$50,000 only if the customer agrees to the fees in writing before contract award. The following countries must approve all contingent fees regardless of value before they can be considered allowable FMS contract costs: Australia, Egypt, Greece, Israel, Japan, Jordan, Republic of Korea, Kuwait, Pakistan, Philippines, Saudi Arabia, Taiwan, Thailand, Turkey, and the Venezuelan Air Force.

SAMM, Section C6.3.7.1 states, if sales commissions are part of a contract proposal, the inclusion should be made known to the purchasing government prior to, or in conjunction with, the submission of the LOA to that government. The notification should include the name and address of the agent; the estimated amount of the proposed fee, and the percentage of the sale price; and a statement either appropriate officials of DoD consider the fee to be fair and reasonable or the USG cannot determine the reasonableness of the proposed fee. This statement is normally included as an LOA note.

LOAs that include contingent fees (regardless of value of the case) and all correspondence with a purchaser on the subject of contingent fees relative to price and availability data or an LOA, and all post-LOA notifications about contingent fees must be coordinated with DSCA.

Foreign Military Sales Customer Involvement in Contracting

The FMS process primarily involves the foreign customer in LOA related issues. After the LOA is accepted, internal USG processes are undertaken to fulfill the LOA requirements. Generally, these internal processes are accomplished without direct foreign purchaser involvement. The SAMM states that sufficient details should be included in the LOA to allow the U.S. contracting officer to negotiate and award a contract without requiring foreign country representation or direct involvement in the formal negotiation process. However, FMS customers often desire to have greater involvement in DoD's procurement processes. The following outlines the areas that the customer may choose to have greater participation and other areas where customer participation is not permitted.

Source Selection

Competitive contract awards are the default procurement method for FMS. As discussed above, the FMS process does provide a process whereby the customer can request the USG contract on a non-competitive basis with a specific vendor in support of an LOA requirement. This process is referred to as a sole source request. Unless the customer submitted a sole source request, the customer

cannot provide input into source selection decisions. LOA standard term and condition 1.2 states the following:

. . . the Purchaser understands that selection of the contractor source to fill requirements is the responsibility of the USG, which will select the contractor on the same basis used to select contractors for USG requirements.

Additionally, the FMS purchaser is not permitted to interfere with a prime contractor's placement of its subcontracts or to direct the deletion of names of firms from potential bidder lists. Customers may suggest that certain additional firms be included because this has the effect of increasing competition. [SAMM, Section C6.3.5.2, and DFARS, 225.7304]

Contract Negotiations

Under FMS, the foreign purchaser has authorized the USG to solely negotiate the procurement contracts that originate from the LOA requirements. LOA standard term and condition 1.2 states the following:

. . . the Purchaser agrees that the US DoD is solely responsible for negotiating the terms and conditions of contracts necessary to fulfill the requirements of this LOA.

Although the USG should be able to accomplish contracting actions without FMS purchaser involvement, the SAMM C6.3.5.2 states that contracting officers should consult with the FMS purchaser any matter that could be perceived as inconsistent with or significantly different from the LOA. Per DFARS 225.7304, FMS purchasers may participate with USG acquisition personnel in discussions with industry to develop technical specifications, to establish delivery schedules, to identify any special warranty provisions or other requirements unique to the FMS purchaser. Additionally, customers may participate in reviewing varying alternatives, quantities, and options needed to make price-performance trade-offs. The degree of participation of the FMS purchaser during contract negotiations is left to the discretion of the contracting officer after consultation with the contractor. USG personnel are not to release any contractor proprietary data unless approved by the contractor. [DFARS, 225.7304]

Contract Pricing

FMS policy states that information concerning FMS contract prices can be provided to the FMS customer in order to demonstrate the reasonableness of the price and to respond to relevant questions concerning contract price. Pricing information may include top level pricing summaries, historical prices, or an explanation of any significant differences between the actual contract prices and the estimated contract price included in the initial LOA price. Per the DFARS 225.7304, the FMS customer is not permitted to observe or participate in negotiations between the USG and the contractor involving cost or pricing data, unless a deviation is granted.

Contract Release

The issue may arise as to whether copies of the USG procurement contract may be released to the foreign purchaser. As noted in the SAMM, Section C6.3.6.2, all pertinent information and contractual obligations between the DoD and the foreign purchaser are identified in the LOA. Consequently, there normally should be no need to provide a copy of the contract to the foreign purchaser. However, if the contract is unclassified and provides only for the requirements of the requesting country without including USG or other country requirements, release can be considered. This does not include negotiation or pricing data.

CONTRACT ADMINISTRATION SERVICES

The contract administration function is an important part of the acquisition process. The scope of contract administration involves the monitoring of all facets of implemented contracts to insure total performance by both the contractor and the USG. Specialists in contract administration, quality assurance, industrial security, financial management, and production management perform contract administration. FAR, 42.3, provides a detailed listing of 70 contract administration functions.

Normally, there will be a procuring contracting officer (PCO) located at the MILDEP or defense agency. The PCO oversees the contract process through the contract award. Following contract award, the contractor may perform contract work at diverse and multiple geographic locations. It therefore becomes impractical for the PCO to be able to perform day-to-day oversight in administering the awarded contract. As a result, the PCO will generally delegate the contract administration functions to an administrative contracting officer (ACO) that is physically located near or at the contractor's facility.

Within DoD, the Defense Contract Management Agency (DCMA) is responsible for contract administration services. DCMA has contract management offices (CMOs) that administer DoD contracts within specific geographic areas or by dedicated CMOs at major defense contractor facilities. The Defense Contract Audit Agency (DCAA) provides audit and financial advisory services in support of DoD acquisitions for FMS.

Foreign Military Sales Contract Administration

Contract administration is an integral part of the FMS process. The customer is entitled to this service as part of the FMS purchase. LOA standard term and condition 1.2 states the following:

When procuring for the Purchaser, DoD will, in general, employ the same contract clauses, the same contract administration, and the same quality and audit inspection procedures as would be used in procuring for itself.

In the LOA, the customer is charged a contract administration service (CAS) fee for FMS materiel and services delivered from procurement. The CAS fee has three primary components: contract administration, quality assurance and contract audit. More information on the CAS fee is contained in later Chapter 12, "Foreign Military Sales Financial Management."

In accordance with the AECA, the cost of quality assurance, inspection, audit and other contract administration services may be waived for North Atlantic Treaty Organization (NATO) members and for NATO infrastructure programs if a reciprocal CAS agreement exists whereby these same services are provided to the U.S. without charge. SAMM, Tables C9.T3 and C9.T5, identify the countries and organizations that have reciprocal CAS agreements with the U.S. A brief description of the content for each CAS fee element is provided below.

- Contract administration includes financial services, contract management, review of contractor systems, price and cost analysis, negotiation of contract changes pursuant to the changes clause, final determination of allowability of costs, convenience and default termination settlements, plant clearance and disposal of contract inventories, and administration of government property.
- Quality assurance consists of inspection, testing, evaluation, and continuous verification of contractors' inspection systems or quality assurance programs. When unfavorable quality conditions are detected, requirements for corrective action by the contractor are

initiated. All FMS requirements have the same quality assurance processes applied that DoD utilizes for its own contracts. The quality assurance function includes the USG inspecting and ultimately accepting or rejecting the contractor's performance under the provisions of the contract. At the point of acceptance, the USG takes title to the material which subsequently transfers to the FMS purchaser at the manufacturer's loading facility prior to shipment per LOA standard term and condition 5.1. USG acceptance of performance is documented by either a DD Form 250 Material Inspection and Receiving Report or by generating a Receiving Report acceptance within the Wide Area Workflow system.

- Contract audit consists of financial services provided by DCAA in connection with the negotiation, administration, and settlement of contracts and subcontracts. These include evaluating the acceptability of costs claimed or proposed by contractors and reviewing contractor cost control systems.

Figure 9-2
DD Form 250

MATERIAL INSPECTION AND RECEIVING REPORT										Form Approved OMB No. 0704-0248	
<p>The public reporting burden for this collection of information is estimated to average 30 minutes per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing the burden, to Department of Defense, Washington Headquarters Services, Directorate for Information Operations and Reports (0704-0248), 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to any penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number.</p> <p align="center">PLEASE DO NOT RETURN YOUR COMPLETED FORM TO THE ABOVE ADDRESS. SEND THIS FORM IN ACCORDANCE WITH THE INSTRUCTIONS CONTAINED IN THE DFARS, APPENDIX F-401.</p>											
1. PROCUREMENT INSTRUMENT IDENTIFICATION (CONTRACT) NO.				ORDER NO.		6. INVOICE NO./DATE		7. PAGE OF		8. ACCEPTANCE POINT	
2. SHIPMENT NO.		3. DATE SHIPPED		4. B/L TCN		5. DISCOUNT TERMS					
9. PRIME CONTRACTOR CODE				10. ADMINISTERED BY CODE							
11. SHIPPED FROM (If other than 9) CODE				FOB:		12. PAYMENT WILL BE MADE BY CODE					
13. SHIPPED TO CODE				14. MARKED FOR CODE							
15. ITEM NO.		16. STOCK/PART NO.		DESCRIPTION <i>(Indicate number of shipping containers - type of container - container number.)</i>		17. QUANTITY SHIP/REC'D*		18. UNIT	19. UNIT PRICE		20. AMOUNT
21. CONTRACT QUALITY ASSURANCE <div style="display: flex; justify-content: space-between;"> <div style="width: 48%;"> a. ORIGIN <input type="checkbox"/> CQA <input type="checkbox"/> ACCEPTANCE of listed items has been made by me or under my supervision and they conform to contract, except as noted herein or on supporting documents. <div style="display: flex; justify-content: space-between;"> <div>DATE</div> <div>SIGNATURE OF AUTHORIZED GOVERNMENT REPRESENTATIVE</div> </div> TYPED NAME: TITLE: MAILING ADDRESS: COMMERCIAL TELEPHONE NUMBER: </div> <div style="width: 48%;"> b. DESTINATION <input type="checkbox"/> CQA <input type="checkbox"/> ACCEPTANCE of listed items has been made by me or under my supervision and they conform to contract, except as noted herein or on supporting documents. <div style="display: flex; justify-content: space-between;"> <div>DATE</div> <div>SIGNATURE OF AUTHORIZED GOVERNMENT REPRESENTATIVE</div> </div> TYPED NAME: TITLE: MAILING ADDRESS: COMMERCIAL TELEPHONE NUMBER: </div> </div>						22. RECEIVER'S USE Quantities shown in column 17 were received in apparent good condition except as noted. <div style="display: flex; justify-content: space-between;"> <div>DATE RECEIVED</div> <div>SIGNATURE OF AUTHORIZED GOVERNMENT REPRESENTATIVE</div> </div> TYPED NAME: TITLE: MAILING ADDRESS: COMMERCIAL TELEPHONE NUMBER: <i>* If quantity received by the Government is the same as quantity shipped, indicate by (X) mark; if different, enter actual quantity received below quantity shipped and encircle.</i>					
23. CONTRACTOR USE ONLY											

DD FORM 250, AUG 2000

PREVIOUS EDITION IS OBSOLETE.

Contract Financial Management

DoD is responsible for making payments to contractors in accordance with the contract. Progress payments to contractors prior to delivery to cover a percentage of cost incurred as the work progresses is a common practice in DoD contracts. The customary progress payment rate on DoD contracts are 80 percent of the total estimated contract cost for large businesses, 90 percent for small businesses, and 95 percent for small disadvantaged businesses. [DFARS, 232.501-1] This rate schedule also applies to contracts awarded for FMS requirements.

Progress payments are often predicted in advance, using cost expenditure curves developed from typical DoD contract expenditure rates. Therefore, the anticipated progress payments, plus any hold back for termination costs, form the basis for the FMS customer's LOA payment schedule.

It is important that LOA data and the actual contract performance progress be kept in balance. The LOA documents the USG's best estimate of cost and delivery information. The FMS customer's expectations are based on the LOA. If deviations from the LOA estimates become apparent during contract performance, the customer should be notified and an LOA amendment or modification issued. Early notification to the customer is important to permit it to decide and exercise any alternate options or to make internal adjustments to accommodate revised cost or delivery schedules.

Any change from the original LOA commitments may be significant to the FMS customer. In one case, a contractor offered the USG the opportunity for early delivery of a major FMS requirement. Historically, contract early delivery has generally been viewed as a positive situation provided there is no increase in total contract cost. In this situation, the government program manager agreed to the early delivery because there was no increase in contract cost. However, accepting early delivery generated an accelerated demand by the U.S. for LOA payments from the FMS customer. The customer's budget was already established to support the original estimate of payments. This decision actually turned out to cause significant problems and dissatisfaction from the FMS customer.

Contract Administration of Direct Commercial Sales

Eligible governments may request contract administration and contract audit functions normally provided by DCMA offices and the DCAA auditors, for direct commercial sales purchases. The procedure is for the foreign customer to submit a letter of request for such services to DCMA.

This service for DCS purchases is normally authorized and reimbursed through a blanket order LOA between the foreign purchaser and DCMA. The LOA establishes an estimated dollar value against which individual requests can be placed throughout a specified ordering period. DCMA may also prepare a defined order LOA to respond to a foreign customer's request for services that are applicable to a specific contract.

OFFSETS

In layman's terms, an offset is a package of additional benefits that the seller agrees to provide or perform in addition to delivering the primary product or service. Offsets generally apply only to acquisitions of major systems. In the international marketplace, there are numerous weapons system producers that offer their system to prospective purchasing countries. When a country makes the decision to procure a foreign system, significant amounts of a nation's cash are going to flow out of that country's economy. Given the cost of today's modern systems, the cash outflow is probably going to be in the hundreds of millions or even into the billions of dollars. As a result, purchasing countries often wish to leverage this huge foreign expenditure to obtain additional benefits for their

nation in addition to acquiring the weapon system itself. This package of additional benefits intended to compensate for the huge financial outflow is referred to as an “offset”.

Offsets are a recognized legal arrangement found in international acquisitions. Offsets in defense trade began in the late 1950s. The first example of U.S. offsets occurred in the early 1960’s with the coproduction of the F-104 jet fighter and Hawk surface-to-air missile in the Western Europe. Today, offsets continue to be part of the defense trade with the aerospace industry representing the majority of all offsets. In terms of defense acquisitions, offset requirements may be established in conjunction with either FMS or a DCS.

Types of Offsets

Various terms are used to describe different types of offset arrangements. The terms offsets, coproduction, buy-backs, barter, counter-purchase, compensation, and counter-trade are often used interchangeably. However, all offsets can fundamentally be categorized into two types: direct offsets and indirect offsets.

A direct offset is a form of compensation provided to a purchaser that involves goods directly related to the item being purchased. As an example, the U.S. contractor may agree to permit the purchaser to produce in its country certain components or subsystems of the weapon system the country is purchasing.

An indirect offset is a form of compensation provided to a purchaser that involves goods which are unrelated to the item being purchased. For example, the contractor may agree to purchase, usually for resale, certain of the customer country’s manufactured products, agricultural commodities, raw materials, or services.

Congressional Interest and Notification

As the number and variety of offset programs has increased, so has the concern of many government agencies, private industries, labor officials, and the media over the impact of offsets on U.S. domestic industries. These concerns include the impact of these trade practices on American jobs, the U.S. balance of payments, technology transfer, and the long term consequences for the U.S. and foreign economies. The president is required to submit to Congress an annual report on the impact of offsets on defense preparedness, industrial competitiveness, employment, and U.S. trade. The secretary of commerce prepares the report in consultation with the secretaries of defense, treasury, and state, and the U.S. trade representative. This annual offset report to Congress is available at <http://www.bis.doc.gov/DefenseIndustrialBasePrograms/OSIES/offsets/default.htm>.

The AECA, Section 36(g) requires congressional notification of proposed FMS and commercial export sales with offset agreements. The information provided to Congress includes a general description of the performance required for the offset agreement. This description should indicate whether or not a known offset requirement exists, whether the country has a standard offset requirement, and whether offsets provided will be direct or indirect and the estimated percentage of each. If there is no offset agreement at the time of the notification, that should be so stated. Reporting of offset agreements is treated as confidential information and remains classified even after the statutory notification is complete.

United States Government Offset Policy

Offsets are permissible under FMS. However, it must be emphasized that the offset agreement is between the purchasing country and the U.S. contractor. The USG is not a party to the agreement

and does not retain any obligation to enforce the contractor's performance of the agreement. Figure 9-4 illustrates the offset relationship. This seems like and, in fact, is an odd arrangement. In an ideal world, the USG would prefer that offset agreements did not exist. However, the reality of the marketplace is that other countries are competing for international business and are willing to provide offset packages to prospective purchasers. If the USG would prohibit offsets from being offered under FMS, the U.S. firms would be at an enormous disadvantage in attempting to compete internationally. As stated earlier, it is DoD's preference to sell American equipment, so, in this environment, the USG must permit American firms to offer offsets to be competitive in the international arena.

The Presidential Policy on Offsets in Military Exports was announced by President George H.W. Bush on 16 April 1990 and was subsequently codified into law by the Defense Production Act Amendments of 1992. The key provisions of the policy on offsets are:

- No USG agency shall encourage, enter directly into, or commit U.S. firms to any offset arrangement related to the sale of U.S. defense articles or services
- USG funds shall not be used to finance offsets in security assistance transactions
- Negotiations or decisions regarding offset commitments reside with the companies involved
- Exceptions require presidential approval through the National Security Council (NSC)

Offset Costs

When a customer requires an offset in association with a major procurement, do they actually obtain the offset benefit at no cost? The fundamental principle of business dictates that any enduring enterprise cannot incur more expenses than revenue it collects. The same is true in offsets. Firms may agree to perform an offset to win an acquisition competition. However, they must recover the cost to perform the offset through the price charged for performing the primary system contract. In a direct commercial contract, the contractor must build the anticipated cost for performing the offset into its contract prices.

Under FMS, the offset cost recovery process is awkward. The USG wants U.S. firms to successfully compete for international business and permits offset arrangements as a legal business activity. Likewise, the USG wants international customers to have the option to purchase military systems using either the FMS process or the direct commercial sales process. Under FMS, the contractor is actually working directly for the DoD, but the USG permits this same contractor to concurrently enter an offset agreement directly with the FMS purchaser. Although DoD is clearly not a party to the offset agreement, the DFARS permits the contractor to build the cost of performing the offset into the contract sale price it charges the USG. Under FMS pricing policy, the USG must recover all costs of conducting FMS through the LOA. As a result, the LOA price will actually be incrementally higher in order to cover the cost of the offset required by the purchaser. So, on the surface, it may appear that the customer is receiving the offset at no cost. This is not true. Offset costs are included as part of the applicable line item unit cost in price and availability (P&A) data and in estimated prices quoted in the LOAs. It is the contractor's responsibility to inform the MILDEP when estimated offset costs have been included in the FMS pricing.

The additional cost to perform the offset will result in a higher contract cost which, in turn, results in a higher FMS cost under the LOA. Although not a party to the offset agreement, the USG serves as the banker for the offset. Although the DFARS states that offset costs will be considered allowable, it does not mean that the contractor does not have to exercise caution in offset performance. The

DFARS requires the contracting officer to review and determine that the contract costs claimed by the contractor are reasonable. It is important to note that the DFARS provision permits offset costs to be included in the costs billed to the USG under the procurement contract only if the LOA is funded with customer funds. If the LOA is funded with FMFP funds, offset costs are unallowable.

Figure 9-3 Offset Relationships

Letter of Offer and Acceptance Offset Note

The DoD is not a party to any offset agreements/arrangements which may be required by the Purchaser in relation to the sales made in this LOA and assumes no obligation to administer or satisfy any offset requirements or bear any of the associated costs. To the extent that the Purchaser requires offsets in conjunction with this sale, offset costs may be included in the price of contracts negotiated under this LOA. If the Purchaser desires visibility into these costs, the Purchaser should raise this with the contractor during negotiation of offset arrangements.

The fundamental principle regarding contracting for FMS requirements is that the USG essentially treats the FMS customer's requirements as if they were USG requirements. In contracting for FMS,

the same contracting regulations, policies and procedures are applied. Per the SAMM, this is one of the principal reasons why customers select the FMS system rather than contracting themselves using direct commercial processes.

The unique aspects of the procurement process that pertain to FMS are few in number, but they have a major impact on the FMS process. Competitive source selection is the norm; however, the FMS customer has the option to use the sole source process if they desire the USG to contract with a specific firm. Under sole source procedures, the FMS customer must include some reasonable justification to support the sole source request. The USG also has established a comprehensive contract administration infrastructure that will be used to oversee the execution of contracts awarded in support of FMS requirements. Again, the USG uses the same contract administration, quality assurance and contract audit processes for FMS that it uses for normal DoD business.

Offsets are a market reality. Offsets are permitted in association with FMS when the LOA funding the procurement contract is financed by customer cash or repayable credit. If the LOA is funded by USG provided grant funds, offset costs claimed by the contractor will be considered unallowable.

REFERENCES

DoD 5105.38-M, *Security Assistance Management Manual* (SAMM), Chapter 3, 5, 6, and 9.

Federal Acquisition Regulations (FAR), Parts 6, 14, 15, 16, 25, and 31.

Defense Federal Acquisition Regulation Supplement (DFARS), Part 225 Foreign Acquisition.

Department of Commerce, *Offsets in Defense Trade*, Eleventh Report.